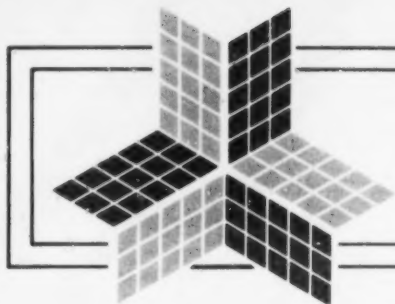




NABE Policy Survey

BUSINESS ECONOMISTS ENDORSE RECENT FEDERAL RESERVE POLICIES, EXPECT MORE OF THE SAME; FAVOR LOWER CAPITAL GAINS TAXES

September, 1989

This report presents the responses of nearly 300 NABE members to a survey on economic policy conducted in late August and early September. The Economic Policy Survey is one of three surveys conducted every calendar quarter by NABE; the other surveys are the Industrial Outlook and the Macroeconomic Forecast. The release of this survey was timed to coincide with NABE's Annual meeting in San Francisco, CA on September 24-27, 1989.

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Highlights from the August Survey

- * The NABE panel strongly endorsed the current thrust of monetary policy. Over 60 percent of respondents thought that the Fed's policy actions were "about right".
- * Over 58 percent of respondents expect the Federal Reserve to encourage lower interest rates over the next 6 months.
- * The majority of the NABE panel expected "the pace of economic growth" to be the biggest influence on Federal Reserve monetary policy over the next 6 months while a significant minority (more than 1/3 of the panel) expected inflation and inflationary expectations to be the dominant influence.
- * A majority of the NABE respondents want the U. S. to attempt to significantly lower its trade deficit.
- * Overwhelming proportions of the NABE survey respondents favor cutting capital gains tax rates and indexing capital gains for inflation, on

capital formation or equity grounds or both, but they want a new proposal to do it.

- * A full 94.9 percent of the NABE respondents expect the U. S. dollar to remain within 10 percent of its current value against the Japanese yen and West German deutschemark over the next 6 months.

Strong Support for Current Federal Reserve Policy

The NABE policy panel members are still very supportive of the monetary policy actions being pursued by Federal Reserve Board Chairman (and former NABE president) Alan Greenspan and his colleagues on the Federal Open Market Committee. A full 60.8 percent of respondents felt that the "current thrust of monetary policy" was about right while 32.1 percent thought it was "somewhat too restrictive" and 4.2 percent thought it was "much too restrictive". In the May survey 74.1 percent thought monetary policy was "about right" and 23.5 percent thought it was "too restrictive".

A full 58.4 percent of respondents expect the Fed to encourage lower interest rates over the next 6 months, either by easing reserve availability or by cutting the discount rate one or more times. This was up sharply from the 41.8 percent of respondents with these views in the May survey.

The panel has totally shifted its views on what economic issue will have the most influence on monetary policy over the next six months. This survey had 55.6 percent of respondents expecting the pace of economic growth to be the major influence while 36.9 percent felt it would be inflation considerations. In the May survey, these percentages were 26.4 percent and 62.5 percent, respectively.

Trade Issues Still A Major Concern.

A majority (55.8 percent) of respondents felt the U. S. should take steps to reduce the trade deficit. Table 1 gives the preferred ways to do this

Table 1

Best Course to Significantly Reduce The Trade Deficit

<u>Method</u>	<u>Percent</u>
Cut the government budget deficit	28.5%
Increase savings incentives in the U. S.	22.4
Improve Competitiveness of U. S. firms	22.0
Encourage worldwide lowering of tariff and non-tariff barriers	13.7
Bring down the value of the dollar	6.9
Put pressure on countries with continuing trade surpluses	5.1

A majority of respondents (52.3 percent) felt that the biggest problem with continuing to run large merchandise trade deficits was a slow reduction

in the long term economic growth rate of the U. S. A minority opinion (13.7 percent) was that there were no significant problems.

Strong Support For Lower Taxes on Capital Gains

The NABE panel registered overwhelming support for the notion of reducing the effective tax rate on capital gains. A full 78.8 percent of respondents favored the general principle of indexing capital gains for inflation and 69.2 percent of them favored cutting tax rates on capital gains.

A large 71.5 percent of respondents felt that indexing capital gains for inflation would result in a more equitable tax system while only 43.2 percent felt that cutting capital gains tax rates would be more equitable. It will be recalled that indexing capital gains was one of the key features of Treasury I that did not make it into the 1986 Tax Reform Act.

There was general agreement that either proposal would increase capital formation in the United States. A large 78.0 percent of respondents felt that indexing would accomplish this while 74.6 percent of respondents thought that cutting the capital gains tax rate would do this.

A full 59.0 percent of respondents felt that cutting capital gains tax rates would increase tax receipts in the first year. A 46.7 percent proportion of the NABE panel thought cutting capital gains tax rates would increase tax revenues over the long run while 34.8 percent of respondents felt tax revenues would fall and 18.5 percent felt there would be no effect in the long run.

The panelists were quite split on the long run tax revenue effect of indexation of capital gains. There were 37.1 percent of the respondents who felt this would decrease tax receipts, 34.8 percent who thought tax revenues would rise, and 28.1 percent who thought there would be no effect.

Interestingly enough, neither of the two main proposals we asked about could muster a majority. The Jenkins-Archer bill to cut capital gains tax rates to 19.6 percent for two years and go to inflation indexing thereafter managed a 42.9 percent approval rating. The competing proposal of Ways and Means Chairman Rostenkowski - to allow indexing for new assets next year-only attracted a 40.1 percent approval. Perhaps economists know only too well how much inflation has raised nominal values of assets over the past twenty years.

A strong majority of respondents was opposed to the idea of having a special 30 percent withholding tax for foreign firms' gains on selling U. S. assets. A full 71.6 percent of the NABE panel respondents registered opposition to this proposal.

Dollar Stability Foreseen

The panelists were asked their opinions on what they expected the dollar to do against the Japanese yen and the West German deutschemark over the next six months. A large group (34.4 percent) expected the dollar to "stay about unchanged" while 36.2 percent expected the dollar to depreciate by less than

10 percent and 24.3 percent expected it would appreciate by less than 10 percent.

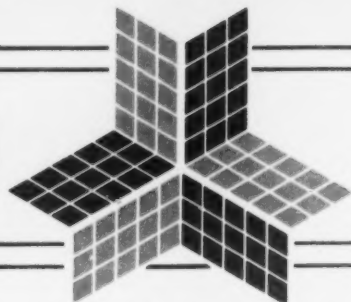
The panelists were similarly split on the long run value of the dollar. A large minority (45.7 percent) think the dollar is overvalued against the same two currencies. A smaller minority (30.1 percent) think the dollar is close to its long run equilibrium value and there were 24.2 percent of the respondents who felt the dollar was undervalued. Clearly, this panel has the necessary diversity of opinion about direction to make for a very active foreign exchange market.



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NABE Policy Survey

Economists Expect Further Monetary Easing; Do not Favor FOMC Restructuring; Oppose Government Action to Curb Stock Market Volatility

January, 1990

This report presents the responses of over 300 NABE members to a survey on economic policy issues conducted in late November, early December. This survey is one of three taken regularly by NABE; the other inquiries are the NABE Outlook and the NABE Industry Survey. For NABE membership information contact the address below.

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Highlights

- * The vast majority of the NABE policy panel believed that current Federal Reserve monetary policy was on target.
- * But, nearly three-fourths of the respondents expected a further easing in monetary policy during the next six months.
- * The pace of economic growth is expected to have the most influence on the course of Federal Reserve policy in the next six months.
- * There was strong opposition to proposals that would change the structure of the Federal Open Market Committee (FOMC).
- * Putting specific monetary policy objectives into legislation (such as zero inflation) was regarded as inappropriate by the NABE panel.
- * Overwhelmingly, the NABE panel was pessimistic that the government would achieve its Gramm-Rudman-Hollings deficit targets in fiscal years 1990 and 1991.
- * While the respondents believed that lower capital gains taxes would aid in paring the deficit, 80 percent opposed its use as a strategy for deficit reduction.
- * A sizeable majority of the panel opposed governmental action to curb stock market volatility.

- * The panel did support some specific measures affecting program trading, however: higher margin requirements for stock futures purchases and extension of the "uptick" rule to program traders.
- * The panel opposed many proposals: a financial transactions tax, a proposal allowing the Fed to directly influence the stock market, and a bill allowing the SEC to have the power of market closure.

Monetary Policy

The vast majority of NABE policy panel members continue to believe that the Federal Reserve's course of monetary policy is appropriate. Fully 72.5 percent of those surveyed believed that monetary policy was "about right," a significant increase from last quarter's survey (when the proportion was 61 percent). Meanwhile, 22.5 percent of the respondents indicated that monetary policy was "too restrictive," a full ten percentage points lower than in last quarter's survey. Only 5 percent of those queried thought that Federal Reserve policy was "too stimulative."

The panel made the following assessments in the context their interpretation of recent Fed actions and the prospects of future monetary policy:

- * 65 percent of the respondents believed that the Fed has been easing monetary policy as opposed to resisting downward pressure from the marketplace, and a greater proportion expect further easing.
- * 74 percent of the respondents expect monetary policy to be eased in the next six months: 34 percent anticipate at least one cut in the discount rate, and 40 percent believe that market rates will be pushed lower by easing reserve availability.
- * Future monetary policy is expected to be primarily guided by the pace of economic growth, according to 66 percent of those queried.
- * Approximately one-fourth of the panel believed that inflation and inflationary expectations would dominate federal reserve policy deliberations in the next six months.
- * 61 percent of the survey respondents believed that the current thrust of monetary policy is best indicated by the level of the Federal funds rate.

Legislative Initiatives and the Federal Reserve

The NABE policy panel is suspicious of recent proposals that would change the structure of the Federal Reserve or that would give it specific legislative directives (Table One). The panel overwhelmingly opposed adding the Secretary of the Treasury to the FOMC (as per the original Hamilton-Dorgan bill). The respondents were also adverse to requiring the Fed to hold meetings with the Administration, or to allowing the Fed to be audited by the General Accounting Office (as per the revised Hamilton-Dorgan proposal). Moreover, by a 3:1 margin, NABE economists disapprove of Congress enacting laws that delineate monetary policy objectives.

Table One: NABE Policy Panel Assessments of Structural Reform Proposals for the Federal Reserve

<u>Proposal</u>	<u>Yes</u>	<u>No</u>
Should the Secretary of the Treasury be on the FOMC?	9%	91%
Should the FOMC be required to meet with the Administration twice a year and should the GAO audit the Fed?	16	84
Should goals for monetary policy be put into legislation?	26	74
Is reducing the inflation rate to zero in the next five years the proper objective of monetary policy?	18	82

A bill proposed by Representative Neal would direct the Federal Reserve to eliminate inflation in five years. More than four-fifths of those surveyed do not think that this is a proper way to state monetary policy objectives: 57 percent because they believe that other policy goals should also be considered, and 25 percent for other reasons. According to the panel, even if the Neal bill is enacted into law, it is unlikely to significantly reduce inflation: only 12 percent of the respondents believe that the inflation rate will be reduced by one percentage point or more per year; 25 percent think that inflation would be slightly lowered; but a full 63 percent do not expect any effect on inflation or expect inflation to be higher.

Part of the panel's negative assessment of the Neal bill stems from disagreement over its underlying rationale. NABE economists were asked to indicate their agreement or disagreement regarding a series of propositions attached to the bill. Most of the propositions received only lukewarm support (mild agreement or disagreement). The exhibit on page 5 illustrates, on a scale of 1 to 5, the support respondents gave each of the propositions (5 indicating strong agreement, 3 neutral, and 1 strong disagreement). The exhibit displays the mean responses. NABE panel members gave their strongest support to the contention that, "Zero inflation will help stabilize the economy and minimize risk and uncertainty in economic decision making, thereby facilitating long-term planning and investment." Nineteen percent of those surveyed strongly agreed with this statement, and 42 percent agreed. There was also support for the proposition that, "Zero inflation will reduce interest rates to, and maintain them at, their lowest possible levels." The clause receiving the least favorable response among survey respondents was, "Zero inflation will promise the highest possible sustainable level of employment." Indeed, 59 percent of those surveyed disagreed with this statement.

As a practical matter, the panel thought that there was little chance that the Neal bill would be passed and signed into law; 90 percent expect it to fail.

Fiscal Policy

The NABE policy panel was overwhelmingly pessimistic that the Gramm-Rudman-Hollings (GRH) targets would be met in either fiscal year 1990 or 1991. Fully 97 percent of those queried believed that the budget deficit would exceed its \$100 billion GRH target this fiscal year and a similar majority was skeptical that the \$64 billion target would be met in fiscal year 1991. In spite of these results, the panel did not support a repeal of the GRH law, probably because they believe it exerts some restraint on the deficit, even though the target is continually missed.

In response to questions on the strategy of deficit reduction, 39 percent of the survey respondents supported leaving the sequester, and the resulting across-the-board cuts, in place for the entire fiscal year, while 52 percent endorsed a reconciliation bill that would trim the deficit by \$14 billion or more. Resoundingly, 75 percent of the panel favored the sequester over minor cosmetic adjustments to the budget. And, although the majority of respondents, 58 percent, believed that a reduction in capital gains taxes would help reduce the deficit, 80 percent objected to its use as a strategy for deficit reduction.

The prospects for military spending appear bleak, according to the panel, but there will be corresponding benefits to deficit reduction. In the near-term, fiscal years 1990 and 1991, 94 percent of the panel expects reductions in inflation-adjusted military spending. Seventy-one percent believed that reductions would be small, while 23 percent anticipated significant cuts (3 percent or more). Over a five-year time horizon, the panel sees much more scope for change: 69 percent expect large reductions in inflation-adjusted military spending, and 29 percent expect small reductions.

Stock Market Volatility

In wake of the 190 point decline in the Dow Jones Industrial Average last October, numerous proposals have surfaced to curb stock market volatility. The NABE panel was asked to assess some of these measures in this survey. The majority, 60 percent, of the respondents did not believe that the stock market volatility needed to be controlled. Nonetheless, 40 percent of the panel favored reducing the volatility.

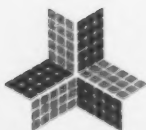
With respect to program trading, an overwhelming majority of those surveyed opposed curbing program trading through governmental action. Indeed, 53 percent of the panel members said that program trading was a symptom of the volatile stock market, rather than the cause. Only 29 percent believed that program trading was the cause of the market's gyrations. Further, 51 percent of the panel thought that the "circuit breaker" which halted trading in stock futures in Chicago on October 13, and thus made some program trading impossible, merely delayed a correction in the market, rather than prevented a market plunge. Twenty-nine percent of the panel believed that the "circuit breaker" was effective in preventing a market plunge, however. The majority of respondents, 60 percent, thought that the New York Stock Exchange's (NYSE) attempts to control "excess volatility" in the market were successful. The NYSE called for a voluntary curb on program trading; imposed new limits on program trading when the stock market declines sharply; provided broader disclosure of program trading activity; and upgraded its system to give more priority to individual investors.

In spite of the opposition to the use of governmental action to reduce program trading, the panel did favor some specific proposals. Eighty percent of those surveyed favored increasing the current margin requirement for stock future purchases of 7 percent to 50 percent, the same level required for stocks. Meanwhile, 68 percent supported extending the "uptick" rule (a rule that prevents the short sale of a stock when its price is falling) to program trade. A sizeable majority (66 percent) opposed the implementation of a tax on financial transactions, while an equal proportion opposed a bill which would give the Securities and Exchange Commission (SEC) the power to close the markets. A proposal advanced by Robert Heller to allow the Federal Reserve to directly support the stock market by buying market instruments in the futures market met with similar disfavor. Sixty-six percent said that it was inappropriate for the Fed to directly influence the market, and an additional 14 percent disagreed with the proposal for other reasons. The panel was split on whether to give the SEC the ability to monitor leveraged buyout activity: 52 percent said such action was necessary, while 48 percent disagreed.

EXHIBIT 1.

ASSESSMENT OF NEAL BILL'S PROPOSITIONS ABOUT ZERO INFLATION

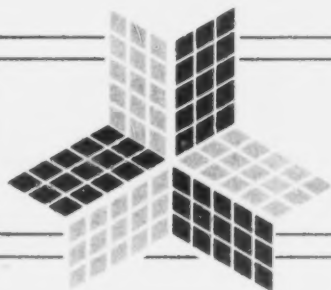
	STRONGLY DISAGREE	DISAGREE	NEUTRAL	AGREE	STRONGLY AGREE	MEAN SCORE
ZERO INFLATION WILL REDUCE INTEREST RATES TO, AND MAINTAIN THEM AT, THEIR LOWEST POSSIBLE LEVELS	1	2	3	4	5	3.47
ZERO INFLATION WILL PROMOTE THE HIGHEST POSSIBLE SUSTAINABLE LEVEL OF EMPLOYMENT	1	2	3	4	5	2.51
ZERO INFLATION WILL GENERATE THE MAXIMUM SUSTAINABLE RATE OF ECONOMIC GROWTH	1	2	3	4	5	2.57
ZERO INFLATION WILL ENCOURAGE THE HIGHEST POSSIBLE RATE OF SAVING AND INVESTMENT, THEREBY BOOSTING PRODUCTIVITY AND ENHANCING OUR STANDARD OF LIVING	1	2	3	4	5	2.95
ZERO INFLATION WILL STIMULATE EFFICIENCY IN PRODUCTION, THEREBY MAXIMIZING OUR COMPETITIVENESS IN WORLD TRADE	1	2	3	4	5	3.05
ZERO INFLATION WILL HELP STABILIZE THE ECONOMY AND MINIMIZE THE RISK AND UNCERTAINTY IN ECONOMIC DECISION MAKING, THEREBY FACILITATING LONG-TERM PLANNING AND INVESTMENT	1	2	3	4	5	3.50
ZERO INFLATION RENDERS THE ECONOMY MORE PRODUCTIVE AND EFFICIENT BY ABOLISHING THE NEED TO DEVOTE RESOURCES, TIME AND ENERGY TO PREDICTING INFLATION AND COPING WITH THE CONSEQUENCES OF IT	1	2	3	4	5	3.26
ZERO INFLATION MINIMIZES THE RISK AND REDUCES THE SEVERITY OF RESSIONS	1	2	3	4	5	2.55
INFLATION IS ESSENTIALLY A MONETARY PHENOMENON, WHICH, OVER REASONABLE PERIODS OF TIME, CAN BE ADEQUATELY CONTROLLED BY THE MONETARY POLICIES OF THE FOMC	1	2	3	4	5	3.21



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NABE Policy Survey

PROBABILITY OF BUDGET DEAL RISES, ALTHOUGH PANEL REMAINS SKEPTICAL; PEACE DIVIDEND SHOULD BE USED FOR DEFICIT REDUCTION; POLICIES OUTLINED IN U.S. - JAPAN TRADE PACT COULD IMPROVE U.S. COMPETITIVENESS, BUT IMPLEMENTATION IS DOUBTFUL.

July, 1990

This report presents the responses of over 250 NABE members to a survey on economic policy issues conducted in late May. This survey is one of three taken regularly by NABE; the other inquiries are the NABE Outlook and the NABE Industry Survey. For NABE membership information contact the address below.

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Highlights

- * Most analysts continue to think monetary policy is about right at present, but if a change is made, easing is expected by a margin of more than 3 to 1 over tightening.
- * The panel is quite evenly divided over whether inflation (48%) or real growth (42%) will be the most important influence upon the Fed in the next six months.
- * The probability of a major budget deficit reduction package has risen, but the panel remains skeptical about the chances of a major, multi-year deal.
- * If an agreement is reached, a majority of NABE policy analysts think it will include reductions in military spending and increased taxes on tobacco, alcohol, and gasoline.
- * A major package would result in lower interest rates, inflation, and--in the long run--faster economic growth; in the short-term, though, growth would be slower.
- * 75% say the top priority for the peace dividend should be deficit reduction.
- * The vast majority of the panel (94%) think Japan unfairly restricts sales of U.S. goods; still, 74% think the U.S. should not restrict imports of Japanese goods.
- * The U.S.-Japanese trade pact contains provisions that could help enhance the U.S. competitive position, but in numerous cases the panel doubts there will be effective implementation -- by either the U.S. or by Japan.

Confidence in Monetary Policy Remains High

NABE policy analysts continue to think that the stance of the Federal Reserve is appropriate: 79% respond to our latest inquiry that monetary policy is "about right" up from 74% in the previous edition of the survey. A plurality (48%) expect the Fed to stay relatively neutral over the next six months, but among those who expect change, easing (40%) wins out over tightening (12%) by a margin of 3 to 1. Most (55%) indicate that the best gauge of monetary policy is the level of the Federal Funds rate.

What economic variable will be the primary influence upon monetary policy in the next six months? 48% of the respondents rank inflation/inflationary expectations as most important versus 42% who side with the pace of economic growth; all other options receive very few mentions. Despite the higher percentage who think the Fed will focus mainly on inflation, this response lost ground between the last two surveys (falling 8 percentage points), while those who believe the pace of growth will get top billing gained (increased 5 percentage points).

Federal Budget Outlook

The previous edition of this survey dealt extensively with federal budget issues. Since that survey, House Ways and Means Committee Chairman Dan Rostenkowski proposed a major deficit reduction plan. In addition, President Bush and the congressional leadership entered into discussions with "no preconditions" in hopes of significantly reducing the budget deficit. (Indeed, after this survey was completed President Bush abandoned his "no new taxes" pledge in an effort to break the stalemate in budget negotiations). Given these developments, we revisited the question of the budget outlook in the current survey.

Prospects for A Budget Deal Have Improved. In light of recent activity, the policy panel concludes that the odds of achieving a major multi-year package have risen: 66% of the respondents say the probability has increased, while only 5% believe it has fallen, and the remainder see no change. Since over 80% think the goal of substantial deficit reduction is either "very important" or "important", the improved prospects are good news. Yet considerable skepticism remains as to the final outcome: Only 7% of the panel thought, when this survey was taken, that real deficit reduction of \$30 - 40 billion per annum over a multi-year period would be obtained from the current round of bargaining. Smaller changes, or a one year package, are regarded as more likely.

Reactions to Rostenkowski Plan. At the time of this writing, the budget summit participants have not unveiled a specific plan. But Representative Rostenkowski proposed a deficit-reduction package that would progressively lower the deficit and balance the budget by 1994. Spending cuts and tax increases would result in cumulative savings of more than \$510 billion by 1995, according to his plan. The NABE policy panel analyzed the proposal in terms of both its economic merit and its political feasibility. Table 1 summarizes the responses, where the scale of 1 (most negative) to 5 (most positive) is used.

A mixed assessment of the Rostenkowski plan emerges from the ratings contained in Table 1. Four proposed actions (excluding suggestions to "forego" certain initiatives) score above 3 on both economic merit and political feasibility: freeze defense expenditures, eliminate the tax "bubble", raise the excise tax on cigarettes, and increase pollution taxes. The other components of the plan are evaluated by the NABE policy group as either poor economics, or politically unlikely, or both. The budget summit is bound to consider options besides those offered by Chairman Rostenkowski, but the economic and political issues are likely to be similar in many respects.

Which Tax Increases, Which Spending Cuts? We asked the NABE economists to assess the likelihood of several specific tax changes and spending cuts, if a major budget package emerges from the current negotiations. Charts 1 and 2 show the percent of the respondents who think each of the individual items will be included.

Table 1
NABE Evaluation of Budget Strategies
(Mean Scores: 1 = lowest, 3 = neutral, 5 = highest)

<u>Provisions in Rostenkowski Plan:</u>	<u>Economic Merit</u>	<u>Political Feasibility</u>
Forego the capital gains tax cut	2.8	3.3
Forego the cut in Social Security taxation	3.3	3.0
Reject all tax cut proposals	2.8	3.1
Freeze defense expenditures, plus 3% inflation-adjusted cut each year	3.9	3.8
Freeze nondefense spending, 1 year	3.5	2.5
Freeze medicare provider rates, 1 year	3.4	2.5
Freeze COLA adjustments, 1 year (including Social Security excluding means-tested programs)	3.6	1.9
Eliminated the tax bubble; add explicit, 33% top income tax rate for income earnings of \$44,900 for individuals and \$74,850 for joint filers	3.2	3.4
Suspend tax indexation (personal exemption and brackets), 1 year, except the earned income tax credit	2.6	2.8
Increase the gas tax from 9.1 cents/gal. to 24.1 cents/gal.	3.5	2.5
Double the excise tax on cigarettes (to 32 cents per pack), beer (to 32 cents a six pack), and wine (to 6 cents per 750 ml. bottle).	3.9	3.8
As yet unspecified, increase in pollution taxes	3.7	3.4
Repeal the G-R-H deficit targets	2.3	2.8

On the tax side, large majorities say that higher excise taxes on tobacco and alcohol would be implemented. A narrow majority think gasoline taxes would rise, while a narrow minority believe capital gains rates would be reduced. The percentage drops off further for the other taxes. Turning to the broad expenditure categories of the budget, a large majority sees defense reductions; no other category is viewed as a likely candidate for large reductions by half of the panel. Importantly, only 14% of the respondents think sizable cuts in the large non-means-tested entitlement programs (such as Social Security and Medicare) would be in such a package.

Impact on the Economy. Finally, an assessment of impacts on the economy was made. Two time horizons were used -- short-term (1-2 years) and longer-term (3 years and more). Table 2 presents the results.

Table 2
Economic Impacts of Major Multi-Year Budget Deal
(Percent of Respondents)

	<u>Lower</u>	<u>No Change</u>	<u>Raise</u>
<u>Short Term Impact (1-2 years)</u>			
Real GNP Growth	61%	25%	14%
Inflation	56%	37%	7%
Short-term interest rates	74%	17%	9%
Long-term interest rates	71%	22%	7%
<u>Long Term Impact (3 years+)</u>			
Real GNP Growth	11%	22%	67%
Inflation	68%	27%	6%
Short-term interest rates	73%	23%	4%
Long-term interest rates	73%	21%	6%

The message is quite optimistic but with one major pitfall. The NABE economists believe that both short and long maturity interest rates would fall, and they would do so during both time horizons. Inflation would also be lowered, although the result is clearer for the 3 year and longer time horizon (where 68% of respondents see slower price advances) than in the near-term (where 56% see a reduction although 37% expect no change). The problem arises with respect to real GNP growth where 67% expect faster growth in the long run, but 61% expect slower growth in the next 1-2 years. The Federal Reserve is likely to come under intense political pressure to ease under such circumstances.

The U.S.-Japanese Trade Pact: The U.S. Controls its own Destiny.

Last year, Carla Hills, the U.S. Trade Representative, cited Japan for unfair trade practices under the Super 301 provisions of the 1988 Trade Act. Once a country has been singled out as an unfair trade partner, the administration is required to negotiate away these impediments within 12 to 18 months. Failure to do so carries the threat of trade retaliation. In an effort to avoid being designated once again as an unfair trade partner, Japan reached a bilateral accord with the U.S. The NABE policy panel was asked to evaluate the agreement and general trade issues with Japan.

Most of the panelists thought that the imbalance of trade with Japan was a problem: 39% said it was a somewhat serious problem and 34% said it was serious. Only 8% believed the imbalance was very serious, and 20% thought it was unimportant. While 94% of those queried stated that Japan unfairly restricts the sale of U.S. goods within its country, nearly three-fourths discouraged use of restrictive trade practices to remedy the situation. The survey respondents (90%) also strongly discouraged restricting Japanese investment in the U.S. Indeed, 75% would approve if the Japanese bought a major bank in the U.S. If, however, the Japanese do not implement the policies agreed upon in the trade pact in good faith, then 56% of those surveyed advocate resorting to retaliatory trade practices.

The panelists believe that the problem of the trade deficit with Japan is largely the result of a savings-investment mismatch in the U.S.; 31% indicated that this was the principal cause of the trade deficit and 12% blamed the U.S. federal budget deficit. Only 14% blamed the trade deficit on unfair trade practices, hence explaining why the panel is not in favor of retaliatory trade practices.

In evaluating the key features of the U.S.-Japanese trade pact, the provisions that panelists believe have the greatest impact on our nation's competitive position are those which the U.S. controls, not actions to which Japan agreed (Table 3). Improvement of the U.S. educational system, expansion of domestic research and development, and reduction of the federal budget deficit are the most important steps that should be taken to shrink the trade deficit with Japan, according to the NABE panel. Unfortunately, the panelists are not convinced that these provisions will be implemented. Survey respondents also give high marks to the trade pact's provision that encourages saving through the U.S. tax code, but, once again, are skeptical of its prospects for implementation.

In terms of the actions to which Japan agreed, reduction of the approval time needed to license large retail stores is viewed as the most favorable provision for America's competitive position, followed by overhauling the Japanese law that favors small retail stores, and granting immediate licenses to stores that devote 1,000 square feet or more to foreign goods. The likelihood of implementing these provisions met with skeptical response from the panelists, however. The issue which was the most controversial in negotiations between Japan and the U.S. dealt with speeding up Japanese public spending projects. This provision ranks favorably with NABE panelists in terms of America's competitive position, and, in spite of the difficult negotiations, is also given the highest marks in the likelihood of implementation. The Japanese provision with the least likelihood of implementation was the overhaul of Japan's system of land taxation which makes it difficult for foreigners to purchase land.

Table 3
NABE Assessment of U.S.-Japan Trade Pact
(Mean Scores: 1 = lowest, 3 = neutral, 5 = highest)

	Impact on U.S. Competitive Position	Likelihood of Implementation
<u>Action Japan Agreed to Take:</u>		
Speed up the patent approval process	3.5	3.1
Overhaul the law which protects inefficient, small retail shops	3.7	2.3
Reduce the approval time required to license large retail stores initially to 18 months, then to 12 months, from the current indefinite period that can last ten years	3.9	2.8
Grant Japanese stores that devote roughly 1000 square feet or more to foreign goods an immediate license	3.6	2.8
Speed up 10 large public spending projects, which could mean business for American companies	3.2	3.1
Abolish requirements that make foreigners give notification before investing in Japan	3.4	2.6
Fully review its system of land taxation which currently makes it difficult for foreigners to purchase land	3.2	2.2

	Impact on U.S. Competitive Position	Likelihood of Implementation
<u>Action U.S. Agreed to Take:</u>		
Encourage saving through tax changes	3.8	2.3
Improve its educational system	4.5	2.4
Expand research and development efforts	4.2	2.8
Reduce the Federal budget deficit	4.1	2.5
Promote exports	3.7	3.4
Liberalize the imports of steel and machine tools	3.2	2.7
Liberalize the export of energy	3.2	2.8

The Peace Dividend

Since the movement toward democracy in eastern Europe, there has been much discussion about the existence of a peace dividend which, proponents argue, should result in lower defense spending. The Administration has given only token recognition of the peace dividend, incorporating a mere \$14.6 billion drop in inflation-adjusted defense spending into its budget. Representative Rostenkowski, meanwhile, is relying upon \$150 billion of cuts in defense spending for his deficit-reduction plan. NABE policy panel members were asked about the prospects for a peace dividend and its potential use.

Given the panelists' favorable response to Rostenkowski's proposed defense cuts, it is not surprising that the majority of panelists believe such a dividend exists. Forty-three percent believe the dividend is between \$20 and \$50 billion, while 37% think the dividend is large, \$50 billion or more. If a dividend results, the overwhelming majority of panelists favor using the funds to lower the budget deficit, with 75% ranking this as their number one choice. Following deficit reduction, infrastructure rehabilitation and improvement of the education system were high priorities. Elimination of the homeless problem ranked last in priority for use of the dividend.

Chart 1.

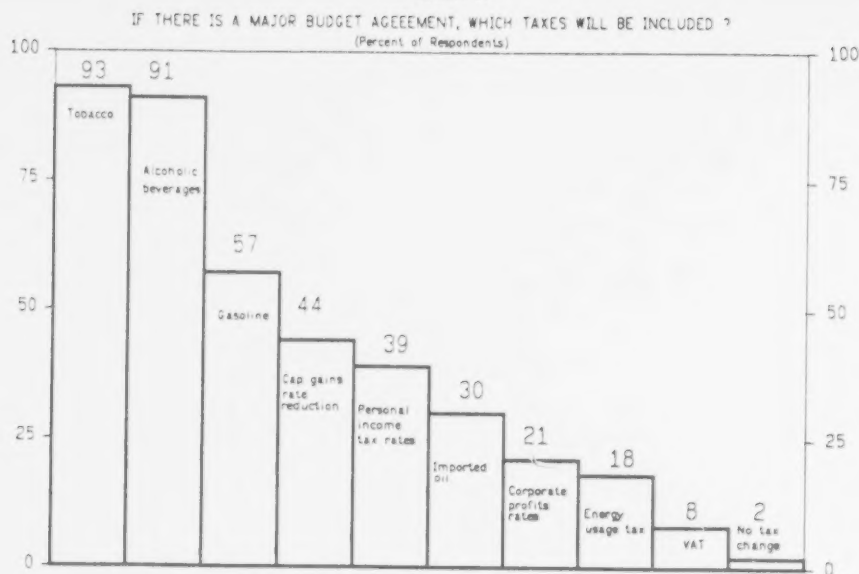
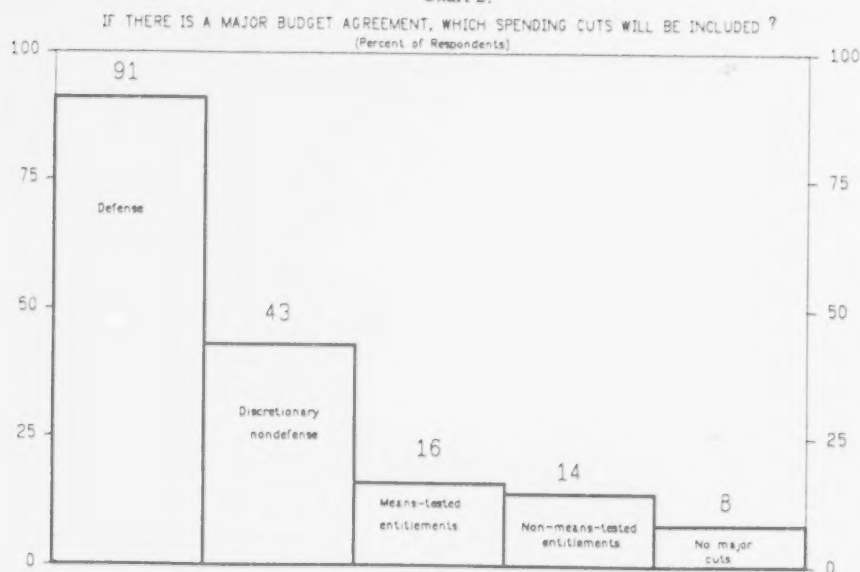


Chart 2.



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